LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 7470
BILL NUMBER: HB 1907

NOTE PREPARED: Feb 1, 2003
BILL AMENDED:

SUBJECT: Interest, Dividends, and Employer Savings Plans.

FIRST AUTHOR: Rep. Lehe
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill exempts interest and $1,000 of dividend income of individuals ($2,000 for joint filers) and estates from taxation under the Adjusted Gross Income Tax. The bill requires an employer that employs at least 50 employees and offers its employees a self-directed retirement savings plan or a deferred compensation plan to provide at least one allocation savings option.

Effective Date: July 1, 2003; January 1, 2004.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the interest and dividend deductions. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Department of Labor (DOL): Under the bill, the DOL must enforce the employer requirement to provide certain savings plan options to their employees. This requirement relates to employers of 50 or more full-time employees that provide a self-directed retirement savings plan or deferred compensation plan for employees. The bill requires such employers to provide at least one asset allocation savings option for such a plan. The DOL must enforce this requirement, including necessary reporting by employers and inspections of employer records. Additional expenses relating to this administrative requirement presumably could be absorbed given the DOL's existing budget and resources. The December 7, 2002, state staffing table indicates that the DOL has 22 vacant full-time positions.

Explanation of State Revenues: The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individuals, trusts, and estates receiving interest or dividend income. The revenue loss from individual taxpayers due to these deductions could potentially total $158.9 M annually beginning in FY 2005 ($147.3 M from the interest deduction and $11.6 M from the dividend deduction). The revenue loss could potentially be higher, to the extent that trusts and estates receive interest and dividend income. (As recent national or state data are unavailable regarding trust and estate returns, the impact from these entities is currently indeterminable.) These estimates are based on interest and dividend totals reported by Indiana filers on federal income tax returns in 2000. These estimates do not account for potential changes in interest and dividend income since 2000. Since 2000, economic and financial conditions have changed significantly with interest rates and stock market indices declining precipitously. Since January 2000, interest rates on one-month and six-month bank certificates of deposit have declined by as much as 70%. During the same period, the Dow-Jones Industrial Average declined by as much 30%, with the annual average for 2002 being about 16% less than the 2000 annual average. Thus, to the extent that interest and dividends correlates with these indicators, the revenue loss in the near-term could potentially be lower.

Background: The bill permits individual AGI Tax filers to deduct interest and dividend income included in Federal Adjusted Gross Income from Indiana AGI. The bill does not limit the amount of interest that may be deducted. The bill does limit the dividend deduction to $1,000 for single and separate return filers, and $2,000 for joint return filers. Under the bill, trusts and estates also would be allowed the interest and dividend income deduction. The dividend deduction is limited to $1,000. Since these deductions are effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.Eighty six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

In 2000, approximately 619,875 Indiana individual tax filers reported an estimated $1,188.6 M in dividends on federal income tax returns. Since the dividend deduction is limited to $1,000 and $2,000, depending upon filing status, the impact is estimated with tax return simulations. Based on these simulations, it is estimated that the dividend deduction reduces the taxable income from this group of taxpayers by about 29%. This taxable income reduction is estimated to total about $342.3 M, resulting in a tax impact of about $11.6 M annually. Approximately 1.5 M Indiana individual tax filers reported an estimated $4,332.4 M in interest income (including an estimated $31.8 M interest from mutual funds) on 2000 federal income tax returns. Since the interest deduction is not limited, the deduction is estimated to reduce taxable income by $4,332.4 M, resulting in a tax impact of about $147.3 M annually.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed deductions would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes. Depending upon the distribution of interest and dividend recipients across the state, the revenue loss in some counties could be substantial.

State Agencies Affected: Department of State Revenue, Department of Labor.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: OFMA income tax databases. "About Half of Dividend Payments Do Not Face Double Taxation," William G. Gale, *Tax Notes*, November 11, 2002. *Potential Federal Dividend Exclusion*, Federation of Tax Administrators memorandum, January 6, 2003. "The Administration's Proposal to Cut Dividend and Capital Gains Taxes," William G. Gale & Peter R. Orszag, *Tax Notes*, January 20,3003.

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